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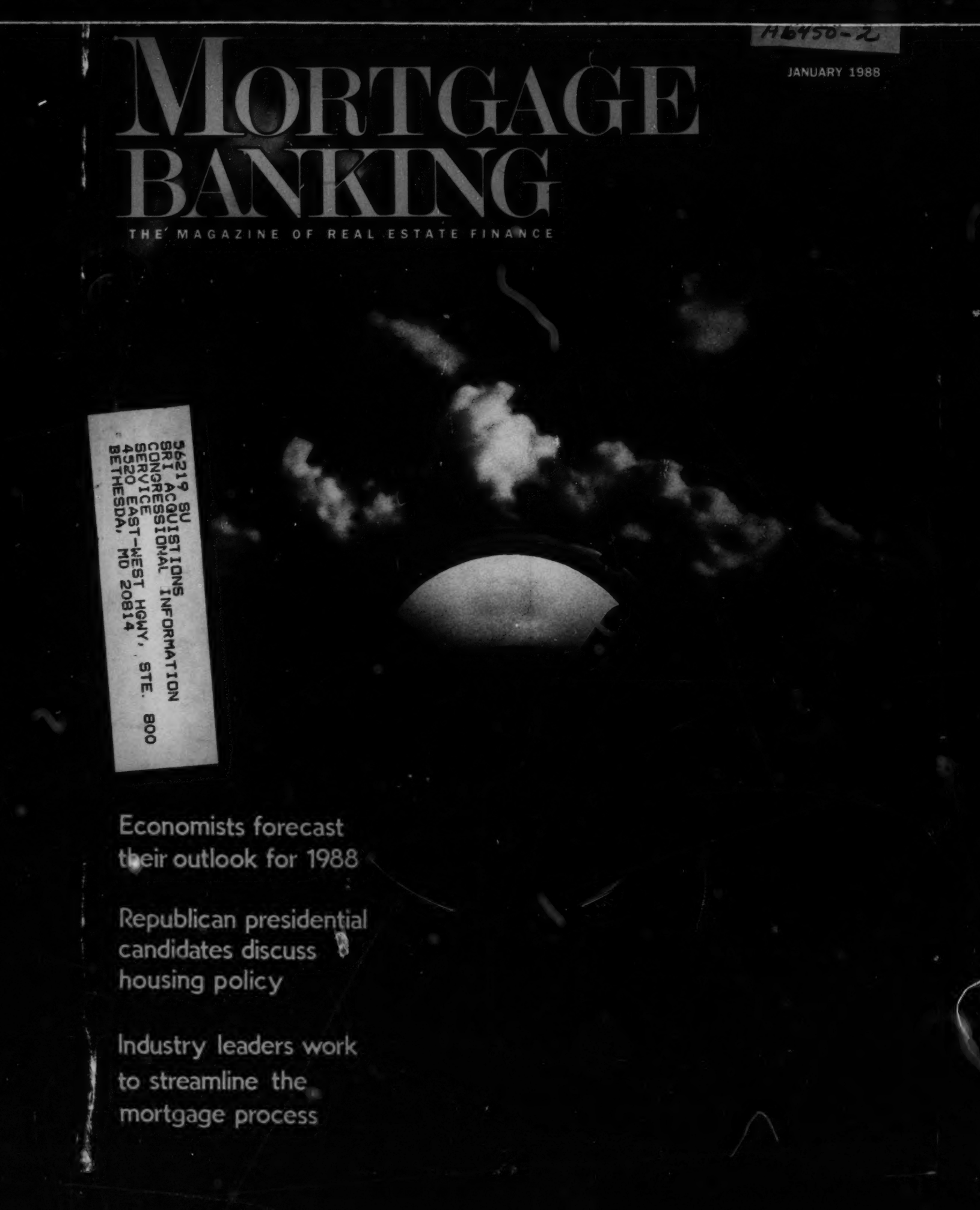
JANUARY 1988

THE MAGAZINE OF REAL ESTATE FINANCE



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Economists forecast their outlook for 1988

Republican presidential candidates discuss housing policy

Industry leaders work to streamline the mortgage process

MORTGAGE BANKING

THE MAGAZINE OF REAL ESTATE FINANCE

VOLUME 48 NUMBER 4

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EDITORIAL PAGE

THE COVER

What do we see in the crystal ball on this month's cover? A reflection of an ambiguous economic environment. We have "blue sky": high employment, low interest rates, and continued growth in GNP, but thick clouds portend an uncertain future. And following "black Monday" on Wall Street, many, many unanswered questions.

Jane DeMarines

Jane DeMarines
Senior Director
of Public Affairs
and Publications

THE ISSUE

January was named appropriately for "Janus" the Roman god of beginnings. Typically depicted in art as a two-faced figure, Janus looks to the future with an eye on the past.

This month we look at the beginning of the new year with forecasts from four nationally respected economists. Like Janus, each looks to the future with an eye on the past.

The year 1988 marks the beginning of a more serious round of political campaigning as the presidential election draws near. Three more candidates speak out about America's housing in our continuing interview series with the candidates.

And, we look at how the industry can open the door for simplification and automation to make the mortgage process easier. But, like Janus, industry leaders will investigate the issue from all perspectives.

And another beginning—please use *Mortgage Banking* as your forum to discuss timely issues and basics of real estate finance. We encourage you to write or call us about articles you would like to see. We hope to build a lively exchange so *Mortgage Banking* can be more valuable to you our readers.

AND A SPECIAL THANKS . . .

Last month, we published an interview with MBA chief economist Lyle E. Gramley about the stock market plunge. A special thanks goes to Tom Marder of MBA's staff who conducted and wrote the interview.

THE ARTIST

The cover photo of this month's magazine is the work of Ed Castle, a freelance photographer located in Silver Spring, Maryland. His work has appeared in the *Washington Post Magazine* and Smithsonian books. He is originally from Staten Island, New York. His specialty is product illustration.

AND NEXT ISSUE

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How the Japanese Look at the MBS

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1988 A PLUS OR MINUS YEAR?

Leading economists from major secondary market agencies, investment banks and the Mortgage Bankers Association of America (MBA) forecast the outlook for real estate finance in 1988.

PHOTOGRAPHY BY ED CASTLE

Macroeconomics . . . Microeconomics . . . Regression analysis . . . Probabilities . . . Economic models. A few years ago, mortgage bankers barely spoke in these economic terms. But, to survive in today's volatile economic climate, a mortgage banker must understand and speak the language. Whether it be for use in originating mortgages or developing marketing strategies, the perspective of industry economists is not to be ignored.

To give *Mortgage Banking's* readers a look into the crystal ball, we asked four respected economists about the prospects for housing and the mortgage market in 1988. Read the outlooks of Lyle E. Gramley, chief economist at the Mortgage Bankers Association of America; Thomas A. Lawler, senior economist at the Federal National Mortgage Association (Fannie Mae); Kenneth T. Rosen, consultant/manager of real estate research at Salomon Brothers and Robert Van Order, chief economist at the Federal Home Loan Mortgage Corporation (Freddie Mac).

Lyle E. Gramley

Lyle E. Gramley, chief economist at MBA, draws on more than 30 years of experience in economics for his forecasting background.

Before coming to MBA, Gramley was a member of the President's Council of Economic Advisors prior to his appointment as a member of the Federal Reserve Board.

Gramley has worked primarily in the public sector starting as a financial economist for the Federal Reserve Board of Kansas City and later working as a staff economist at the Federal Reserve Board and director of the Board's division of research and statistics.

Gramley is also a senior staff vice president at MBA and writes regularly for Mortgage Banking *about economic issues.*

The economy headed into the fourth quarter of 1987 growing at a strong pace. A new dynamism had developed in the industrial sector of the economy fueled by a substantial increase in the physical volume of merchandise exports during the previous year and a pronounced slowdown in the physical inflow of imports other than oil. This new dynamism evidenced itself in an upswing in manufacturing employment in the third quarter of 1987, growth in industrial output at a pace not seen since early 1984 and a sizable rise over the spring and summer months in unfilled orders for durable goods. Absent the stock market crash that culminated in a 508 point decline in the Dow-Jones Industrial Average on October 19, 1987, prospects for continued economic expansion in 1988 were excellent.

The decline in equity values since the stock market peaked last August is clearly a negative for the economy in 1988, but the extent of drag is difficult to assess. Given the underlying strength of the economy, a recession seems unlikely. Indeed, the Mortgage Bankers Association of America (MBA) economics department expects real gross national product (GNP) to increase about 2¼ percent in 1988, less than in 1987 but a solid increase for the sixth year of an economic expansion. In fact, significantly faster growth would worsen the outlook for inflation, for interest rates and for housing.

Absent the stock market crash that culminated in a 508 point decline in the Dow-Jones Industrial Average on October 19, 1987, prospects for continued economic expansion in 1988 were excellent.

Lyle E. Gramley

Consumer prices are expected to increase about 4½ percent in 1988, somewhat less than last year largely because the oil price bulge of early 1987 is unlikely to be repeated. The underlying inflation rate—the rise of consumer prices excluding food and energy—is expected to worsen somewhat in 1988 because of an acceleration of wage rate increases. This will limit the room for downward movement of interest rates, even though economic growth this year will be slow. Interest rates on fixed-rate mortgages are expected to average about 11¼ percent in 1988, roughly a percentage point above 1987 levels, but below the peak levels reached in early October 1987.

Housing starts are expected to decline about 8 percent this year to an average of 1,520 thousand. New and existing home sales should be down by roughly comparable amounts. Both single-family and multifamily starts are expected to decline, but the effect of higher average mortgage interest rates will be felt somewhat more in the single-family market. Mortgage loan originations will decline considerably more than new and existing home sales because refinancing loans will be a smaller share of the total.

This is not a particularly bright outlook for mortgage lenders. The decline in the stock market, however, may obviate the need for a substantial tightening of monetary policy to avoid economic overheating this year. Indeed, the outlook for housing appears somewhat brighter after the stock market's crash than it did before. □

Thomas A. Lawler

Thomas A. Lawler, vice president and senior economist at Fannie Mae, has specific responsibilities for economic forecasts and analysis at the secondary marketing agency.

Lawler gained experience as senior research associate at the Federal Reserve Bank of Richmond and vice president for financial planning and budgeting at Chase Manhattan Bank before joining Fannie Mae.

In addition to his forecasting duties at Fannie Mae, Lawler also analyzes the pricing and funding of mortgage products and writes for Fannie Mae's weekly financial market newsletter.

The last two years have been none too kind to most folks in the economic forecasting profession. As 1986 came to a close, the consensus forecast called for economic growth in 1987 to be fairly weak. The Federal National Mortgage Association (Fannie Mae) thought otherwise, especially in the first part of the year. In fact, the economy performed quite well in the first three quarters of 1987 with real gross national product (GNP) growth averaging 3.6 percent. By the third quarter of 1987, the consensus forecast had become decidedly more upbeat with most economists (but not

Fannie Mae) expecting no significant slowdown in economic growth until 1989.

Then came the stock market crash of October 1987, and economists found themselves scurrying to revise their forecasts. Some economists now think that a recession is imminent; others think otherwise but look for only moderately slower economic growth; and still others have thrown up their hands, and said they cannot produce a forecast in this environment.

Fannie Mae, also, has revised its economic and financial forecast in light of the recent turmoil in the financial markets. In early October Fannie Mae was looking for near-term strength in the economy and continued upward moves in interest rates. But Fannie Mae also thought that a slowdown in the economy would emerge by spring and that interest rates would subsequently reverse most of these earlier increases. Little known was that the rate cycle expected to last for about nine months would instead take only nine days to run its course.

In Fannie Mae's view, the October plunge in the stock market will shake consumer confidence sufficiently to produce a significant slowdown in consumer spending. This slowdown, in turn, will push business inventories higher in the last quarter of 1987, and production cuts are likely in the first quarter of the year to get inventories back in line. These developments will cause GNP growth to slow to a crawl in early 1988.

The plunge in stock prices is by no means, however, a sure sign that the economy is about to enter a recession, and, in fact, Fannie Mae does not expect a recession in 1988. The stock market is only one of many leading economic indicators, and other indicators have for the most part been quite encouraging. Moreover, the Federal Reserve's quick action to inject massive amounts of liquidity into the banking system following the stock market dive should provide the economy with some offsetting monetary stimulus. The trade sector should also continue to bolster the demand for U.S. goods, especially in light of the renewed downturn in the dollar. On balance, real GNP growth of about 2 percent can be expected with growth picking up as the year progresses.

The near-term outlook for both inflation and interest rates has improved considerably, and inflation should remain fairly subdued through the early part of 1988. Interest rates have already fallen significantly since the stock market crash—although just prior to the crash they had risen sharply—and some further modest declines are expected in the months ahead. Looking further out, however, the outlook is less sanguine. Federal Reserve policy has clearly become much more stimulative since October, and with this shift the dollar has fallen sharply. While this policy response to the turmoil in the stock market seems appropriate, it does carry some risk that inflation down the road will pick up—and in fact, Fannie Mae believes that as 1988 progresses new evidence will emerge that the trend in inflation is rising. Fannie Mae expects inflation to average about 4½ percent for the year as a whole but move closer to 5 percent in the latter part of the year.

The near-term effect of the stock market crash on housing will probably be negative despite the resulting drop in interest rates. This is mainly because the heightened uncertainty caused by the market's behavior is likely to produce a wait-and-see attitude on the part of many homebuyers. The upscale market should be affected the most especially in some areas of the Northeast. As the financial markets calm down, however, the improved interest rate outlook should help single-family housing, and Fannie Mae expects declines in single-family housing starts and home sales of only about 5 percent.

The near-term effect of the stock market crash on housing will probably be negative despite the resulting drop in interest rates.

Thomas A. Lawler

The outlook for multifamily construction remains rather dim: rental vacancy rates were still rising in the third quarter of 1987 despite previous cutbacks in starts. As a result, some additional weakness in multifamily housing starts seems likely in 1988. Total housing starts of about 1.55 million units are expected for the year as a whole versus an estimated 1.65 million units in 1987.

Turning to the originations market, Fannie Mae projects a significant slowdown in one- to four-family mortgage originations for 1988. Interest rates will be higher during most of 1988 than rates were in all but a few months of 1987, and as a result the refinance market will remain fairly small. Refinancings accounted for an estimated 40 percent of the total originations market in 1986 and the first half of 1987. With this segment of the market much lower and with home sales expected to fall modestly, originations will decline by about 27 percent in 1988 to $290 billion. Adjustable rate mortgages (ARMs) will remain fairly popular during most of the year, although the ARM share will fall somewhat from its current high level and average about 50 percent of the conventional market.

After the experience of 1987 there is little certainty attached to any forecast for 1988. There are simply too many unknowns to feel even remotely confident about any forecast, and this certainty should be taken into account in formulating business plans for next year. □

Kenneth T. Rosen

Kenneth T. Rosen brings Wall Street/academic experience to his forecasting. Rosen presently is the consultant/manager of real estate research at Salomon Brothers in New York City. Also, he is the chairman of the Center for Real Estate and Urban Economics and

holds a professorship at the University of California, Berkeley.

After earning a Ph.D. in economics from Massachusetts Institute of Technology, Rosen was a research associate at Harvard University and a professor of economics at Princeton University.

He writes extensively about real estate economics and finance for numerous publications.

To set the stage, let us look at the first nine months of 1987. We have seen interest rates edging up since April. Treasury bill rates were up from a low of 5 percent to 7 percent by mid-October while Treasury bonds in the same period rose from 7¼ percent to 10¼ percent. Long-term residential mortgage rates approached 12 percent. These rate rises were accompanied by vigorous economic activity and higher inflation rates. The stock market collapse in mid-October has at least temporarily altered these trends. Treasury bill rates have fallen back to the 6 percent level, and Treasury bond rates have eased back to around 9 percent.

As a result, it is likely that the economy will slow down during the next six months because of the shock to consumer confidence. The net effect for housing in 1988 will be substantially lower levels of activity in new construction, resales and refinancings.

Salomon Brothers expects new housing starts to be in the 1.4 million range, down from 1.8 million in 1986 and 1.6 million in 1987. The brunt of the decline will be in single-family homes, which should drop to slightly below 1 million starts, while multifamily homes should stabilize at approximately 400,000 starts. The market should show greater strength in the Midwest and West with the East and Northeast looking weaker, compared to the robust activity they have enjoyed in the last few years.

If fixed rates remain above 10 percent, Salomon Brothers expects the majority of this year's originations to be adjustable rate mortgages (ARMs), which make home purchases more easily affordable.

Kenneth T. Rosen

Existing home sales should decline to 2.9 million from an estimated 3.3 million sales in 1987.

Mortgage origination activity will be down sharply this year, reflecting the difficulty in originating fixed-rate product, a virtual cessation of refinancings and a curtailment of new construction. Total single-family originations in 1988 should be $290 billion, compared to an estimated $375 billion in 1987. If fixed rates remain above 10 percent, Salomon Brothers expects the majority of this year's originations to be adjustable rate mortgages (ARMs), which make home purchases more easily affordable.

Multifamily originations will also experience substantially reduced volume, again reflecting reductions in refinancings.

The mortgage securities market is likely to offer fewer new issues because most volume has traditionally been in fixed-rate mortgages. The supply of derivative product, however, which includes collateralized mortgage obligations (CMOs), real estate mortgage investment conduits (REMICs), strips, and interest only/principal only (IO/POs), should continue strong as these new instruments meet investor demand for controlled risk return products.

New office construction should fall from 260 million square feet of space in 1987 to 190 million square feet in 1988 (on a nationwide basis). There will be a continued adjustment to high vacancy rates in the office sector. The industrial sector should show slight declines in new construction in markets where capacity utilization is low.

Salomon Brothers expects to see a great deal of regional divergence in employment growth for 1988. Chart 1 is a sample of employment statistics compiled by city through September 1987. □

CHART 1

Top 10 in employment gain September 1986 through September 1987 (best first)	Top 10 in employment slowdown September 1986 through September 1987 (worst first)
Las Vegas, NV	Dallas, TX
Riverside/San Bernardino, CA	Austin, TX
West Palm Beach/Boca Raton, FL	Oklahoma City, OK
Orlando, FL	New Orleans, LA
Gary/Hammond, IN	Houston, TX
Portland, OR	Kansas City, MO
Wichita, KS	Denver, CO
Orange County, CA	Tulsa, OK
San Diego, CA	*Tucson, AZ
Sacramento, CA	*Scranton, PA

*Scranton and Tucson's employment actually rose slightly.

Robert Van Order

Freddie Mac's chief economist Robert Van Order gives another perspective from a secondary market agency's viewpoint. Currently, Van Order does primary and secondary mortgage market analysis and research, macroeconomic analysis and forecasting for Freddie Mac.

Before joining Freddie Mac, Van Order worked as an economist at the Department of Housing and Urban Development (HUD) and later directed the housing finance analysis division. Van Order also has teaching experience at the University of California, Los Angeles (UCLA); Purdue University; University of Southern California; Queen's University in Canada and the American Univer-

sity in Washington, D.C. While at UCLA, he designed a MBA program about the secondary mortgage market.

When he was a senior research associate at The Urban Institute of Washington, D.C., he analyzed the mortgage markets in underdeveloped countries.

Last October's stock market crash—the earthquake that shook the world's financial markets—has altered the economic landscape. The substantial fall in household wealth has increased the likelihood of a recession this year. However, the net effect of the stock market collapse on housing may be positive. Interest rates already have come down dramatically from their mid-October peak, and this is good news for homebuyers.

The stock market crash primarily reflected the internal dynamics of a speculative mania. Throughout the world, the bull market had reached a stage where investors were ignoring conventional valuation principles that would have kept stock prices from rising as fast as they did earlier in the year. By early October the possibility of a stock market crash became a significant risk. Once stocks began to fall the latent fear that they had been overvalued all along took over.

I expect the economy to continue to grow into the first half of 1988, with the real possibility of a recession hitting in the third quarter of the year. The recession will be a typical postwar slump, not a repeat of the 1930s. I see no signs that the economy has sustained structural damage, such as a banking system collapse.

> The crash may serve to remind people that housing is an investment whose value is less volatile than that of equities.
>
> Robert Van Order

The impetus for slowdown will come from three sectors: consumer spending, business investment and exports. Consumption will in-

Housing Starts, Home Sales and Mortgage Originations

	1987				1988				Yearly Total	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1987	1988
	actual				projected					
Housing Starts[1]	1.8	1.6	1.6	1.6	1.6	1.6	1.6	1.5	1.7	1.6
Total home sales[1]	4.3	4.3	4.1	4.0	4.0	4.0	4.0	3.9	4.2	4.0
Originations for Purchase[2] ($ bill.)	$52	$85	$77	$48	$49	$73	$78	$53	$262	$253
Refi[2] ($ bill.)	$52	$52	$15	$12	$11	$12	$12	$12	$131	$47
Total originations	$104	$137	$92	$60	$60	$85	$90	$65	$393	$300
ARM share (percent)	27	29	53	55	50	45	35	35	41	41

1. Millions of units, seasonally adjusted annual rate. In contrast, quarterly estimates of originations do contain seasonal influences.
2. Freddie Mac estimates
Figures provided by Robert Van Order, Federal Home Loan Mortgage Corporation

Major Economic Indicators

	Percent change at annual rate, except as noted							
	1987				1988			
Indicator	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	actual				projected			
Real GNP	4.4	2.3	3.8	2.9	2.8	0.5	−1.5	−1.5
Consumer prices	5.3	4.9	3.9	4.5	4.5	4.5	4.7	4.7
Unemployment rate (level)	6.7	6.2	6.0	5.9	5.9	5.9	6.0	6.4

Figures provided by Robert Van Order, Federal Home Loan Mortgage Corporation

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crease slowly, if at all, because households will take a cautious stance toward big-ticket purchases. Business investment will respond with a longer lag to lower stock prices because it takes time for firms to revise capital spending plans. However, the current state of the market means that earnings are more likely to be used to shore up the financial condition of firms (through stock buybacks, for example) than to invest in new plants and equipment. In any event firms are less likely to install new capital when they can buy used capital cheaply in the stock market. Finally, exports may weaken as the stock market collapses that took place overseas cause foreigners to reduce spending.

Given the lags in the labor market, the unemployment rate will not go up much until the fourth quarter of this year. The recession I project for 1988 does not really affect my inflation outlook—except for 1989 and beyond, when inflation may drift down somewhat because of the weaker economy. While I foresee the probability of a recession, I do not foresee a collapse on the order of the Great Depression; the monetary system is much more stable now, and the monetary authorities more experienced in the use of open market operations. I see a mild recession, one that will probably be less serious than recent downturns.

Notwithstanding the recent decline in interest rates, the bond markets remain anxious, creating difficulties for policy-makers. Even though a recession during an election year is thoroughly unpalatable, it is not clear that the means for avoiding it are available. For example, the standard fiscal antidote to a recession is a tax cut or expenditure increase, which seem to be unlikely in the current environment. Similarly, the bond markets may get nervous if there is too much money growth before we see the whites of the next recession's eyes.

I suspect that interest rates already have come down about as much as they can until it becomes clear whether or not a recession will indeed occur. If the projected recession takes hold, look for a decline in rates in the latter half of this year.

The surge in interest rates that took place through early October really threatened to hurt the housing market. Thus, the outlook for housing is slightly better now than it was before the stock market crash. On the one hand, it is true that the decline in wealth engendered by the crash will make homebuyers more cautious. However, on the other hand, interest rates are more than 100 basis points lower than they were before the crash, which makes housing more affordable. Moreover, the crash may serve to remind people that housing is an investment whose value is less volatile than that of equities.

Putting all the factors together, I expect housing starts and home sales to remain at the levels seen in recent months. Before October 19, the outlook was for the housing market to weaken. Moreover, the reduction in rates for 30-year fixed-rate loans ought to restore life to that market, reducing the adjustable rate mortgage (ARM) share. □

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MINNESOTA MUTUAL
WORKING HARD TO MAKE LIFE EASIER.

Is hazardous waste a major, growing long-term problem for the mortgage banking community—or merely a passing distraction to be relegated to the bottom of the closing checklist once some new concern captures the fancy of the academic community?

Lenders' problems with pollution and hazardous waste contamination have grown as federal, state and local governments have passed comprehensive environmental regulations and laws imposing liability for cleaning up the environment on land owners. Lenders have key concerns about the growth of regulations which impose cleanup liability on an absolute or "no fault" basis. And, public awareness keeps pace with these government regulations. In turn, this awareness creates a fear, and in some cases an unreasoned fear, which can cause market values to decrease at the slightest hint of contamination.

What are the principal hazardous waste contamination risks that the lending community faces? There are four. First is the risk that the collateral may lose value after the market learns about asbestos or hazardous waste contamination. Second is the risk that the borrower cannot repay a mortgage if the borrower must also pay the cost of cleaning up a contaminated property. Such cost can be enormous: the average cleanup cost of a federal superfund site exceeds $10 million. Third is the risk that a mortgage will lose priority to a cleanup lien. This problem exists in the seven so-called superlien states: Connecticut, New Hampshire, Maine, Massachusetts, New Jersey, Tennessee and Arkansas. In each of these states a lien granted to the state securing the cost of cleaning up hazardous waste contamination may have priority over a lender's mortgage.

Finally, and most frightening to the lending community, is the risk that the lender may become directly liable for the cost of cleaning up a contaminated site. This results from the Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA) recently amended by the Superfund Amendment and Reauthorization Act of 1986 and the two lender liabilities cases *United States of America v. Maryland Bank & Trust Company*, 24 ERC 1193 (D. Md. 1986) and *United States v. Mirabile*, 15 Envtl. L. Rep. 20992 (E.D. Pa. 1985).

Is there more smoke than fire? Perhaps. Most would agree, although perhaps no one can prove, that the recent losses resulting from the softening of the national office market far outstripped all losses attributable to hazardous waste contamination. Further, since *Maryland Bank* and *Mirabile* in 1986, no reported decisions similarly threatened lenders, and no lending institution has lost the priority of its mortgage under any of the seven state superlien statutes. Although in at least two instances, administrative proceedings resulted in settlements which were adverse to the lender.

Whether the attention currently being focused on these issues is disproportionate is a matter of opinion. However, lenders now devote substantial resources to hazardous waste contamination problems. The industry is developing new underwriting and risk management procedures and revising mortgages, guarantees, indemnities and other loan documents to address the risks of hazardous waste contamination.

Environmental liability hides under the ground and behind the walls. Learn how lenders across the United States manage the problems of hazardous waste contamination.

Watch Out for the HIDDEN THREAT

Lenders Tell How

Richard D. Jones

ILLUSTRATION BY MICHAEL CRAIG

Market share and profit hang in the balance as each institution grapples with these issues. Market share and profits may decline to reduce an institution's exposure to potential losses from hazardous waste contamination; particularly if some institutions remain willing to "throw the dice" and not address these risks. A comprehensive, rigorous hazardous waste policy will force lenders to reject loans which would otherwise be made and impose significant new transactional costs on borrowers who were hardly enthusiastic about closing costs before the advent of this problem.

To assess what, if any, consensus may be developing about the nature and severity of hazardous waste issues and what should or can be done to combat these risks, an informal survey on hazardous waste contamination policy was recently circulated in preparation for a speech to the Mortgage Bankers Association of America (MBA). This survey does not claim to scientific rigorousness. When the data was analyzed by various categories of institutions (size, location, type, market, etc.) some results suggest the sample was simply too small to allow any but the most tentative conclusions. However, the results do provide useful insight about an industry grappling with a new and significant problem. Nearly 140 lenders nationwide representing commercial banks, savings and loans, life companies, finance companies, real estate investment trusts (REITs) and other financial institutions with more than $3.5 trillion in aggregate assets provided data about hazardous waste and asbestos.

A lender can assess the risks resulting from hazardous waste contamination only by an environmental audit which investigates the property to be mortgaged, its ownership history and use.

To begin, most respondents thought the hazardous waste problem is here to stay. Of the sample, 77 percent of respondents expected problems associated with hazardous waste contamination will become more acute, 97 percent expect no improvement and only 3 percent thought the situation will improve. Further, no significant differences on this key question appeared among regions nor type nor size of institutions.

While the level of concern about hazardous waste problems is high, only 15 percent of the sample are involved in a federal or state environmental enforcement action with the problems about evenly split between hazardous waste and asbestos. Only 2 percent were named in any federal or state enforcement proceeding or litigation.

While awareness about the hazardous waste contamination problem is high, relatively few institutions have policy manuals or in-house education programs for loan officers and underwriters. Overall, only 41 percent of the sample use a policy manual to evaluate hazardous waste contamination and only 39 percent use such a tool to assess asbestos contamination. Moreover, only 15 percent have an in-house training program. This last percentage is particularly troubling because policies and policy manuals are generally ineffective without formalized training about the issues. However, a number of respondents did say that they are developing manuals and education programs, and it is likely that the number of institutions with these programs will steadily increase.

The questionnaire revealed very modest regional differences in the use of these in-house education programs, reliance on environmental audits and the incidence of loan applications rejected because of hazardous waste concerns. Not surprisingly, the larger institutions, the life companies and those companies located in regions with the oldest industrial plants and highest population densities such as the Northeast, are more likely to have such programs and procedures. However, no regional differences are large.

-Based upon the policy manuals submitted with the survey, it seems clear that "case-by-case" analysis remains the watch word for the industry. One can conclude that lenders, and particularly smaller lenders, use caution about the market impact of lending policies which increase the transactional cost of closing loans or which require the rejection of loans which the lender would otherwise make.

A lender can assess the risks resulting from hazardous waste contamination only by an environmental audit which investigates the property to be mortgaged, its ownership history and use. This environmental audit should include, but not be limited to:

- The preliminary professional assessment of the risk for a site including physical examination by a professional consultant who observes the vegetation and soils, location of tanks, transformers, capacitors, pits, drying ponds or lagoons; locates piping and drains; and searches for visible asbestos in buildings, evidence of dumping, odors, presence of transformers, etc.
- The identification of ground water classification and basic information regarding the geologic and hydrogeologic characteristics of the site.
- The review of the present and prior use of the site and surrounding areas, including identification of the location of any Environmental Protection Agency (EPA) Superfund or state cleanup sites, or other known contaminated property.
- The identification of raw materials and wastes generated from current and prior industrial/agricultural use

of the site.

- The review of the records of the EPA and state or local agencies and the applicable land records for enforcement actions, citations, prior remedial action, EPA registration as a generator or transporter, etc.
- Interviews with abutters, local governmental officials and employees of any current or prior operator of the property.
- Aerial photographs of the site over time.
- Boring, soil and water testings if preliminary analysis indicates a potential problem.
- Representations and warranties from owner and tenant/users.

Is this type of protocol in general currency? Does the industry effectively assess the risk of hazardous waste contamination when it makes loans? The record appears to be spotty. A healthy 72 percent of the sample use environmental audits periodically as part of their loan underwriting. However, only 30 percent do such an audit in more than 80 percent of cases, and 35 percent of the sample use an audit less than 20 percent of the time. Again, there is little indication of regional differences or differences between commercial banks and savings and loans. The large institutions, including a preponderance of life companies, are more likely to insist on environmental audits with 93 percent of institutions larger than $50 billion in assets and 87 percent of institutions with assets of between $10 and $50 billion relying on such audits.

A truly comprehensive environmental audit will test the soil and water samples from the site. If the paper au-

SURVEY OF LENDERS ABOUT ENVIRONMENTAL LIABILITY

1. **a.** Does your institution have a written policy on how to evaluate hazardous waste contamination or other environmental risks associated with properties which will secure a loan?

   Yes [41%] No [56%] Unsure [2%] NA [1%]

   b. On asbestos?

   Yes [39%] No [54%] Unsure [5%] NA [2%]

2. Do you have an in-house training program on hazardous waste contamination?

   Yes [15%] No [84%] Unsure [1%]

3. **a.** Do you require an environmental audit of properties you mortgage?

   Yes [72%] No [16%] Unsure [4%] Occasionally [7%] NA [1%]

   b. If so, do you require subsurface investigations including boring and ground water and soil sampling?

   Often [25%] Occasionally [49%] Rarely [11%] NA [15%]

   c. On what percentage of loans is an environmental audit required?

   Less than 20% [35%] 20-80% [26%] 80-100% [30%] NA [9%]

   d. In what percentage of cases do you require subsurface analysis?

   Less than 20% [52%] 20-80% [28%] 80-100% [8%] NA [12%]

4. When environmental reports are required, do you or your borrower typically choose the environmental engineer?

   Lender [44%] Borrower [42%] Both [6%] NA [8%]

5. **a.** Does your institution retain an environmental engineering firm to assist in reviewing environmental audits submitted by borrowers?

   Yes [21%] No [70%] Unsure [5%] Occasionally [2%] NA [2%]

   b. Do you have this engineering capacity in-house?

   Yes [20%] No [75%] Unsure [2%] NA [3%]

6. Do you have guidelines on the qualifications of the environmental consultants whose reports you will accept?

   Yes [35%] No [58%] Unsure [5%] NA [2%]

7. **a.** Do you require a borrower and/or guarantor indemnity on hazardous waste contamination liability or costs?

   Almost Always [46%] Generally [20%] Occasionally [11%] Always [1%]

   Rarely [6%] Never [11%] No Loan [1%] NA [4%]

   b. When aware of a significant possibility of contamination?

   Almost Always [61%] Generally [7%] Occasionally [5%] Always [1%]

   Rarely [1%] Never [5%] No Loan [7%] NA [13%]

8. How often have you declined a loan application due to concern with hazardous waste contamination?

   Often [7%] Occasionally [46%] Rarely [24%] Never [21%] NA [2%]

9. **a.** Have you been involved in federal or state environmental enforcement problems on a property in your portfolio?

   Yes [15%] No [77%] Unsure [7%] NA [1%]

   b. Type of problem:

   [7%] Hazardous Waste
   [3%] Asbestos
   [1%] Other
   [4%] Hazardous Waste, Asbestos and Other
   [85%] NA

   c. Has your institution been named in any federal or state enforcement proceeding or litigation?

   Yes [2%] No [64%] Unsure [14%] NA [20%]

10. Have you increased a loan to allow a borrower to pay for the cost of environmental clean up?

    Yes [10%] No [83%] Unsure [7%]

11. **a.** Will you loan on property containing asbestos?

    Yes [48%] No [37%] Unsure [14%] Rarely [1%]

    b. If yes, do you require an engineering report on removal or encapsulation?

    Yes [54%] No [3%] Unsure [4%] NA [39%]

12. Do you use a yield premium to offset increased environmental risk?

    Yes [10%] No [75%] Unsure [11%]

    Rarely [1%] Occasionally [1%] NA [2%]

13. Do you expect environmental contamination to become more of a problem within the next five years?

    More [77%] Less [3%] About same [17%] Unsure [2%] No [1%]

dit indicates possible contamination, further testing may be essential. Subsurface analysis is expensive—generally costing a minimum of $2,000 because of the need for drilling, maintenance of monitoring wells and laboratory analysis of results. This in-depth analysis is also time-consuming often requiring three to eight weeks. In case after case, the wait for the environmental audit delays closing and frustrates the borrower.

Reflecting the market's resistance to pass additional costs on to borrowers, only 8 percent of the sample require subsurface analyses 80 percent of the time or more. Fifty-two percent require an analysis in less than 20 percent of cases. Institutions with more than $10 billion in assets and those institutions located in the Northeast and Mid-Atlantic regions rely on subsurface investigation more often than other institutions. Little difference exists between commercial banks and the savings and loans; however, as a group, the life companies show the highest level of mandatory subsurface investigation with 53 percent requiring subsurface investigation in 80 percent of cases.

What happens after an environmental audit is done? How a lender uses and interprets these reports raises a number of difficult questions. Is the firm selected to do the audit qualified to perform it? In most states, environmental consulting is not a licensed profession. The increased market for environmental audits attracts many firms to the industry, but some companies, unfortunately, are not qualified. The environmental consultant must have adequate qualifications to perform a valid audit. Only 35 percent of the sample have guidelines about qualifying environmental consultants. The sample was split evenly about who should choose the consultant. If the borrower retains the consultant, the consultant should formally acknowledge the obligation and responsibility it has to the lender.

Secondly, what should the consultant's report address? Reports in circulation today range from the most sketchy windshield-type assessments to the weighty and scientific documents that are exhaustive and exhausting. While the survey did not effectively isolate data on this point, it appears that relatively few lenders specify what the elements of an acceptable report are.

A basic checklist for such a report should include:

- Statement of consultant's qualifications.
- Statement of scope of services.
- Statement of procedures used and inquiries made by the consultant.
- Technical, narrative analysis of data including copies of all laboratory reports.
- Conclusions.
- Recommendations about removing the contamination.
- Consultant's acknowledgment of lender's proposed reliance on the report and consultant's duty of care to lender (regardless of who retained the consultant).

Finally a qualified consultant finishes a report; what does it mean? The limitations and qualifications of these reports now often outweigh the substantive report. Further, the reports are increasingly quantitative and technical. To the non-technical person, the result, intentionally or unintentionally, can be completely obscure.

What to do? Twenty-one percent of the sample retained their own consultant to help them understand the various reports obtained from borrowers, and another 20 percent used in-house engineers. Using this sort of technical resource will likely expand as it becomes increasingly apparent to lenders that prudent underwriting requires understanding, and not just receiving environmental audits.

Every lender will sooner or later encounter an environmental audit identifying hazardous waste, petroleum contamination or asbestos in a property it wants to finance. Indeed, as environmental consultants become increasingly careful and audits become more comprehensive, audits will find contamination. Borrowers will force lenders to make loans on these contaminated properties. Moreover, no matter how thorough the environmental audit, lenders will make loans on the assumption it is free of contamination.

How can lenders limit or manage the resulting risks? One approach is to reject the loan. In the survey, 53 percent either often (7 percent of the time) or occasionally (46 percent of the time) reject a loan because of environmental concerns. Of course, rejecting the loan is not always a practical alternative. In many cases both borrower and lender want to make the loan even with contamination.

How can the lender manage the risk and make the loan? Indemnity from the borrower is one solution. Surprisingly, only 46 percent of the sample require borrower and guarantor indemnities "almost always." An additional 20 percent require such an indemnity "generally." This is surprising because, unlike other measures such as environmental audits that protect lenders from liability, the indemnity does not add to transactional costs. Eighty-eight percent of lenders in the Northeast region generally or almost always require the

Every lender will sooner or later encounter an environmental audit identifying hazardous waste, petroleum contamination or asbestos in a property it wants to finance.

indemnity compared with 57 percent of California institutions and 27 percent of the Midwest institutions that do so. Among institutions with assets of $50 billion or more, 85 percent generally require the indemnity while 76 percent of those institutions with assets of $10 billion to $50 billion generally require it. Indemnities vary widely. Negotiating the content of the indemnity may be the major legal battleground in mortgage lending for the foreseeable future. Many institutions use the following example of a basic indemnity:

> "To the full extent permitted by applicable law, Borrower, *(beneficial owners)*, and guarantors hereby agree to defend, indemnify and hold harmless Lender, its directors, officers, employees and agents from and against any and all loss, cost, expense or liability incurred in connection with any and all claims or proceedings (whether brought by private party or governmental agencies) for bodily injury, property damage, abate or remediation, environmental damage or impairment or any other injury or damage resulting from or relating to any hazardous or toxic substance or contaminated material located upon or migrating into, from or through the Property, (whether or not the release of such materials was caused by Borrower, a tenant or subtenant or a prior owner or tenant on the Property and whether or not the alleged liability is attributable to the handling, storage, generation, transportation or disposal of such substance or the mere presence of the substance on the Property), which Lender may incur due to the making of this Loan, the exercise of any of its rights under the Loan Documents, or otherwise. For purposes of this Indemnity, hazardous or toxic substances or contaminated material includes but is not limited to asbestos, oil and petroleum products and those substances within the scope of all federal, state and local environmental laws and ordinances including the Resource Conservation and Recovery Act, the Comprehensive Environmental Response, Compensation and Liability Act, the Superfund Amendment and Reauthorization Act of 1986 and Title 22a of the Connecticut General Statutes. This indemnity will survive foreclosure of the mortgage or conveyance in lieu of foreclosure and the repayment of the loan and the discharge and release of the mortgage and other loan documents."

Other approaches require the borrower to clean up the contamination or increase the loan's interest rate to compensate for increasing risk. Surprisingly, only 10 percent of the sample increased the loan amount to pay for the cost of remediation with a larger number requiring the completion of the cleanup before loan closing. Only 12 percent increased the interest rate to offset the increased risk. As the industry gains experience in dealing with contamination risks, lenders will find new solutions for managing hazardous waste contamination while making loans.

This survey shows how the real estate lending industry struggles with the issues of hazardous waste contamination. Clearly, consensus on risk analysis and management has not yet developed. The industry's approach to these problems will evolve for some time to come. In large measure, the future course of national enforcement of our environmental laws will affect any consensus. Today lenders fear the risk of hazardous waste contamination rather than confront the risk. Rigorous enforcement of the nation's environmental laws will greatly affect the lending community. If this occurs, the industry will be challenged to respond. It can meet that challenge by thinking out comprehensive loan policies about hazardous waste, starting education programs and developing a national consensus of how the lending community can clean up contaminated properties. □

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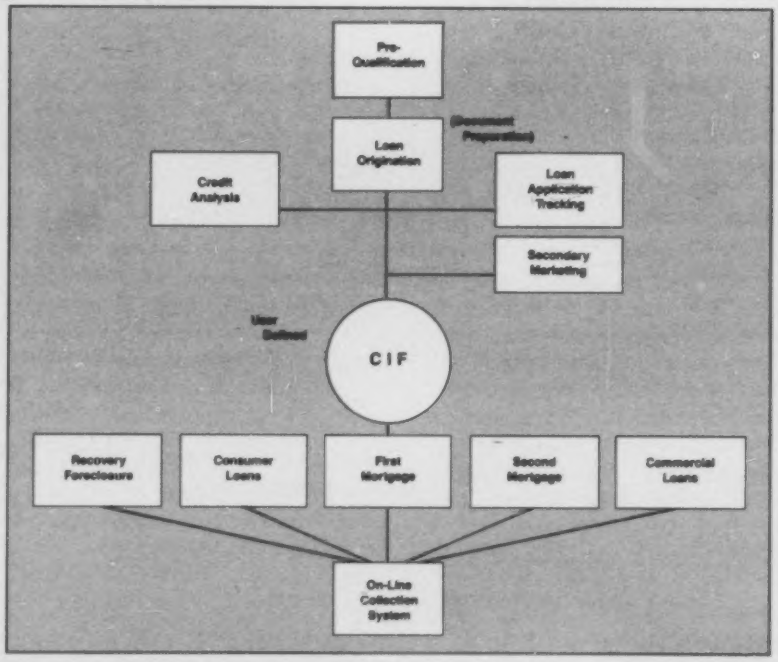

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1987												
MAY	158	120	38	1,606	1,197	409	136	104	32	1,493	1,100	393
JUN	165	123	42	1,586	1,173	413	156	118	38	1,517	1,124	393
JUL	152	117	35	1,598	1,202	396	141	104	37	1,487	1,080	407
AUG	144	107	37	1,585	1,170	415	128	95	33	1,502	1,106	396
SEP	149	112	37	1,648	1,241	407	137	95	42	1,502	1,072	430
OCT$_p$	**135**	**101**	**34**	**1,513**	**1,170**	**343**	**123**	**90**	**33**	**1,451**	**1,057**	**394**
1986 TOTAL	1,805	1,262	543				1,769	1,185	584			
1985 TOTAL	1,742	1,166	576				1,733	1,077	657			
10 MONTHS												
1987	1,410	1,062	348				1,340	982	358			
1986	1,577	1,101	476				1,526	1,031	495			
1985	1,497	1,015	482				1,487	937	550			
1984	1,524	1,046	478				1,452	932	520			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1987																
MAY	28	28	60	37	297	309	623	377	26	28	50	33	274	284	575	360
JUN	28	35	57	43	256	287	607	436	29	29	59	40	276	266	605	370
JUL	28	26	57	41	278	255	636	429	27	27	49	37	279	255	555	398
AUG	27	28	53	36	250	272	641	422	23	24	48	33	257	250	606	389
SEP	23	30	61	36	244	295	690	419	25	29	49	34	247	284	576	395
OCT$_p$	**24**	**24**	**53**	**35**	**246**	**238**	**615**	**414**	**23**	**26**	**45**	**29**	**246**	**281**	**557**	**367**
1986 TOTAL	294	296	733	484					283	290	687	510				
1985 TOTAL	252	240	782	468					560	237	753	484				
10 MONTHS																
1987	232	257	551	371					237	251	504	349				
1986	253	257	650	417					244	250	603	429				
1985	215	210	668	405					222	204	639	422				
1984	168	213	760	383					168	182	704	399				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands) EXISTING HOUSES[1]	NEW HOMES Sold	NEW HOMES Available For Sale	NEW HOMES Months Supply at Current Rate	VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions) Seasonally Adjusted Annual Rate Total	1 Unit	2+ Units	Non-res.	CONSTRUCTION STATUS (Units in thousands) Seasonally Adjusted Annual Rate Under Construction Total	1-4 Units	5+ Units	Completions Total	1-4 Units	5+ Units
1987														
MAY	346	62	355	6.8	228.1	112.8	26.6	88.7	1,061	670	391	131	94	37
JUN	360	58	359	6.8	224.8	113.1	25.0	86.7	1,059	669	390	147	108	39
JUL	333	55	360	6.6	226.2	114.1	23.8	88.3	1,053	672	381	143	101	42
AUG	319	57	363	6.5	228.5	114.4	23.9	90.2	1,049	672	377	152	107	45
SEP	294	54	364	6.6	228.6	116.0	23.5	89.1	1,054	676	378	143	109	34
OCT$_p$	**na**	**51**	**366**	**6.5**	**228.6**	**116.7**	**23.7**	**88.2**	**1,051**	**677**	**374**	**148**	**113**	**35**
1986 TOTAL	3,565	749										1,756	1,206	550
1985 TOTAL	3,214	688										1,704	1,170	534
10 MONTHS														
1987	2,765*	652										1,382	983	399
1986	2,706	593										1,435	980	455
1985	2,448	590										1,398	956	442
1984	2,250	559										1,369	939	430

*9-month totals

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL Total	Mtg. Bankers[3]	S&Ls	Banks[2]	Life Cos.	1-4 UNITS Total	Mtg. Bankers[3]	S&Ls	Banks[2]	Life Cos.
1987										
FEB	$46,348	$10,518	$13,140	$20,985	$1,705	$32,897	$10,012	$10,773	$11,897	$215
MAR	58,138	14,311	18,044	22,906	2,877	42,300	13,876	15,084	12,787	553
APR	64,179	15,043	21,260	25,236	2,640	48,463	14,507	18,100	15,458	398
MAY	63,448	13,305	21,157	26,212	2,774	46,949	13,013	18,107	15,695	134
JUN	65,219	10,121	23,453	28,840	2,805	46,706	9,609	19,489	17,278	330
JUL$_p$	**57,797**	**8,182**	**19,800**	**26,869**	**2,946**	**39,563**	**7,806**	**16,733**	**14,652**	**372**
1986 TOTAL	603,948	142,884	218,118	205,503	37,443	438,441	131,628	176,063	126,936	3,814
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	242,112	63,296	109,286	68,224	1,306
7 MONTHS										
1987	400,065	81,228	129,799	171,764	17,274	289,984	77,614	108,764	101,383	2,223
1986	312,553	73,583	111,769	109,284	17,917	226,910	68,715	91,447	64,909	1,839
1985	184,388	33,458	75,969	62,370	12,591	122,467	31,227	57,317	33,431	492
1984	175,871	33,330	77,815	55,992	8,734	123,189	31,187	59,205	32,322	475

LENDER ACTIVITY (Cont'd.)

LONG-TERM MORTGAGE LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1987										
FEB	$2,581	$222	$1,144	$1,080	$135	$10,870	$284	$1,223	$8,008	$1,355
MAR	2,852	71	1,431	1,017	333	12,987	364	1,530	9,102	1,991
APR	3,857	60	1,404	2,146	247	11,859	476	1,756	7,632	1,995
MAY	2,771	60	1,570	807	334	13,728	232	1,480	9,710	2,306
JUN	3,768	284	2,028	1,164	292	14,745	228	1,936	10,396	2,183
JUL$_p$	**3,174**	**236**	**1,499**	**1,053**	**386**	**15,060**	**140**	**1,568**	**11,164**	**2,188**
7 MONTHS										
1987	21,896	1,462	10,417	8,158	1,859	88,185	2,152	10,618	62,223	13,192
1986	18,434	3,140	9,170	3,982	2,142	67,209	1,728	11,152	40,393	13,936
1985	13,108	1,028	7,628	3,413	1,039	48,813	1,203	11,024	25,526	11,060
1984	12,039	348	7,390	3,514	787	40,643	1,795	11,220	20,156	7,472

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1987										
FEB	$39,709	$10,941	$16,795	$9,682	$2,291	$140,143	$20,664	$51,689	$51,524	$16,266
MAR	48,241	12,078	22,955	10,116	3,092	137,753	20,110	53,750	47,902	15,991
APR	49,919	11,247	24,471	10,556	3,645	139,074	19,788	56,532	45,943	16,811
MAY	53,969	11,302	24,203	14,730	3,734	151,197	22,151	57,828	53,200	18,018
JUN	47,463	6,429	24,594	13,836	2,604	139,189	14,507	56,330	51,138	17,214
JUL$_p$	**37,430**	**5,600**	**20,516**	**7,849**	**3,365**	**142,544**	**13,490**	**53,857**	**57,754**	**17,443**
1986 TOTAL	527,397	128,480	231,915	127,902	39,100					
1985 TOTAL	324,089	59,551	170,755	61,311	32,472					
7 MONTHS										
1987	350,123	64,641	147,702	73,442	64,338					
1986	355,919	75,998	136,090	68,378	75,453					
1985	171,014	27,593	92,749	33,233	17,439					
1984	162,382	29,098	91,017	29,886	12,381					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1987												
MAY	216	104	38	74	230	15,837	149	9,265	36	2,621	45	3,951
JUN	212	93	43	76	220	15,565	121	7,566	47	3,424	52	4,575
JUL	193	89	37	67	210	14,885	117	7,341	41	2,978	52	4,566
AUG	166	77	32	57	225	15,678	142	8,902	37	2,819	46	3,957
SEP	148	68	26	54	175	12,437	99	6,180	33	2,488	43	3,769
OCT$_p$	**138**	**56**	**24**	**58**	**108**	**6,999**	**79**	**4,816**	**29**	**2,183**	**42**	**3,745**
1986 TOTAL	3,283	1,908	452	923	1,852	127,759	921	56,901	345	24,720	586	16,138
1985 TOTAL	2,194	902	251	1,041	1,333	87,485	410	23,964	192	13,046	731	50,475
10 MONTHS												
1987	2,115	1,114	372	629	2,030	141,797	1,187	73,801	405	29,921	438	38,075
1986	2,866	1,696	375	795	1,487	102,490	721	44,444	275	19,697	491	38,349
1985	1,858	744	202	912	1,099	71,949	327	19,081	148	10,006	624	42,862
1984	1,592	378	169	1,045	1,235	79,332	241	13,093	172	11,022	822	55,217

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC* Comm. to Sell	FHLMC* Comm. to Buy	FHLMC* Mtg. Purc.	FHLMC* Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1987										
MAY	$1,726	$1,718	$116,861	$7,086	$6,730	$5,170	$7,996	$7,768	$10,220	$8,367
JUN	1,745	1,690	121,270	6,648	6,781	6,309	7,864	7,436	14,077	8,440
JUL	2,373	1,569	125,461	5,842	5,521	2,715	7,252	6,825	7,594	8,807
AUG	2,276	1,613	127,881	3,997	4,462	4,452	5,031	4,721	6,533	8,245
SEP	1,842	1,743	130,540	4,083	n.a.	n.a.	n.a.	4,158	16,472	6,499
OCT$_p$	**1,566**	**1,278**	**133,102**	**3,819**	**n.a.**	**n.a.**	**n.a.**	**3,111**	**n.a.**	**n.a.**
1986 TOTAL	32,987	30,826	—	60,566	106,563	136,179	103,474	102,443	152,911	98,169
1985 TOTAL	20,225	19,848	—	23,649	44,025	56,689	44,012	41,454	64,360	45,868
10 MONTHS										
1987	19,400	15,487	—	54,154	57,303	61,918	63,225	61,806	106,420	83,344
1986	29,905	25,942	—	49,437	66,762	93,863	58,255	55,821	119,355	66,211
1985	17,170	18,225	—	17,815	27,988	31,569	26,802	24,088	46,014	30,303
1984	16,099	13,463	—	9,903	17,153	18,166	11,380	10,451	27,527	21,883

*Year-to-date totals are eight months for FHLMC, and nine months for GNMA.

INTEREST RATES AND YIELDS

1- to 4-UNIT MORTGAGES

YEAR AND MONTH	FHA OPINION SURVEY FHA New[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.
1987							
JUN	10.33%	10.29%	10.29%	9.45%	9.38%	8.69%	9.995%
JUL	10.38	10.22	10.23	9.44	9.43	8.45	9.773
AUG	10.55	10.37	10.38	9.38	9.41	8.91	10.007
SEP	11.22	10.86	10.87	9.37	9.25	9.43	10.643
OCT	10.90	10.84	10.87	9.25	9.22	9.71	11.030
NOV$_p$	**n.a.**	**n.a.**	**n.a.**	**9.35**	**9.32**	**9.06**	**10.345**

CURRENT SECONDARY MARKET YIELDS

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]
1987			
JUN	9.69%	9.70%	9.65%
JUL	9.62	9.64	9.59
AUG	9.79	9.73	9.70
SEP	10.43	10.29	10.25
OCT	10.64	10.61	10.57
NOV	**10.03**	**9.86**	**9.82**

SELECTED SECURITIES

YEAR AND MONTH	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1987				
JUN	10.05%	8.40%	5.99%	6.92%
JUL	10.17	8.45	5.76	6.65
AUG	10.37	8.76	6.15	6.71
SEP	10.84	9.42	6.61	7.37
OCT	11.07	9.52	6.69	7.89
NOV	**10.39**	**8.86**	**6.19**	**7.17**

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1987				
JUN	28	129	130	125
JUL	21	117	119	114
AUG	18	103	97	94
SEP	15	101	87	83
OCT	−17	112	109	105
NOV	**n.a.**	**117**	**100**	**96**

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.